

For purposes of the Illinois sales tax laws, lessors of tangible personal property under true leases are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. (This is a GIL).

December 3, 1999

Dear Xxxxx:

This letter is in response to your letter dated October 28, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

Our firm represents a finance company client that is requesting a response regarding sales/use tax obligations on hearing aids under various situations. In all cases, the obligations are originated through an approved dealer network which is unrelated to the finance company.

Option one:

The patient purchases a hearing aid from a hearing clinic, but needs to finance the purchase. If the patient has acceptable credit, the finance company would then purchase the installment contract from the originating dealer via an assignment of the contract.

Option two:

The patient leases the hearing aid. The lease is based on the following set of assumptions:

- Lease term is 36 months
- Lease is non-cancellable
- Lessee must pay first month lease payment and security deposit up front
- At the end of the lease term, the lessee will have the option to return the hearing aid and receive the security deposit back, or purchase the hearing aid for fair market value
- The first 12 months of the lease is covered by a manufacturer's warranty
- During the remaining 24 months of the lease, the finance company will provide loss, damage, or repair coverage on the hearing aids.

The customer is responsible for a deductible in the case of a lost unit and is fully responsible for subsequent replacement units.

*The finance company believes the above fact pattern would result in an operating lease transaction.*

Option three:

The patient leases the hearing aid and has a bargain purchase option.

*The finance company believes the above fact pattern would result in a sales-type lease transaction.*

Please respond to all questions below for each fact pattern above.

- a.) Is there a medical exemption from sales tax for this transaction?
- b.) Is there special qualifying circumstances in order to meet the medical exemption? And if so, can you please define these circumstances?
- c.) If this transaction is subject to tax, is it subject to sales tax or use tax? Who is responsible for the payment of tax, the originating dealer, the finance company, or the customer?
- d.) Regardless of the responses to the above questions, is my client required to obtain a sellers permit and file reports?

Please respond to the above at your earliest convenience. Should you need additional information, please contact me directly at ####.

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

All gross receipts from sales of tangible personal property in Illinois are subject to Retailers' Occupation Tax unless an exemption is specifically provided. Medicines and medical appliances are not taxed at the normal rate of 6.25%. These items are taxed at a lower rate of 1% plus applicable local taxes. See the enclosed copy of 86 Ill. Adm. Code 130.310. Items subject to this lower tax rate include prescription and nonprescription medicines, drugs, medical appliances, and insulin, urine testing utensils, syringes, and needles used by diabetics, for human use.

A medicine or drug is defined as any pill, powder, potion, salve, or other preparation intended by the manufacturer for human use and which purports on the label to have medicinal qualities. A medical appliance is defined as an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body. See part (c) of Section 130.310. Medical devices that are used for diagnostic or treatment purposes do not qualify for the lower tax rate. Hearing aids qualify for the lower rate of tax.

In answer to your questions, hearing aids are not exempt from sales and use taxes, but are subject to the lower rate of tax because they substitute for a malfunctioning part of the body. In a true lease situation as set forth above, the lessor is responsible for paying the Use Tax to his supplier when purchasing the hearing aid for lease. In a conditional sales situation as set forth above, the seller/lessor has a Retailers' Occupation Tax liability while the purchaser/lessee has a corresponding Use Tax liability.

For your information, we have enclosed a copy of 86 Ill. Adm. Code 130.1960 which is the Department's regulation for "Finance Companies and Other Lending Agencies--Installment Contracts--Repossessions." The Retailer's Occupation Tax is based upon gross receipts from sales of tangible personal property. Please

note at 86 Ill. Adm. Code 130.1960(c)(1) that "[w]hen a retailer of tangible personal property *sells* an installment contract or 'paper' to a third party, the difference between the selling price of the tangible personal property and the selling price of the installment contract or 'paper' is a cost of doing business and is therefore not deductible in computing Retailers' Occupation Tax liability. Retailers' Occupation Tax is measured by the total selling price of the tangible personal property purchased from the retailer for use or consumption. Upon sale of the installment contract or 'paper' to a third party, Retailers' Occupation Tax becomes due based on the entire selling price to the purchaser of the tangible personal property, with credit allowed for any tax already remitted to the Department based on the receipts from the sale of the tangible personal property."

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk  
Enc.